INFLATION
UNEMPLOYMENT

WHO IS TO BLAME?

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Inflation and Unemployment

1. Who do the Tories blame?

The British economy is suffering from the worst inflation for 20 years and the highest unemployment for 30 years. It has been in a condition of near-stagnation for the past two years and investment in manufacturing industry is tending to decline. What are the causes of all this?

The Tories throw all the blame on the trade unions for making "wildly inflationary wage claims". They argue that excessive wage increases cause excessive price increases, and that the more rapid growth of the economy, which would reduce unemployment, is "frustrated by inflation". Therefore the trade unions are responsible for both unemployment and inflation. Mr. Barber, Chancellor of the Exchequer, has said:

"I am in no doubt whatever that the major cause of the increase in unemployment is the absurdly high level of many of the pay settlements which we have experienced since the autumn of 1969."

and he added that

"by obtaining these absurdly high wage increases workers are pricing themselves out of a job". (*The Times*, 22.4.71.)

And Mr. Heath has claimed that "wage inflation has been the main reason for both higher prices and higher unemployment". (*The Times*, 20.4.71.)

This must rank as one of the most absurd doctrines ever propounded by any British political leaders. To argue that rising wages and salaries directly cause a growth in unemployment is just plain nonsense. Exactly the opposite is more plausible: since wages and salaries are the biggest component of total demand, an increase in wages and salaries will tend to create more jobs because it will put more money into the hands of the public. Indeed, it is conceded by economists that the high level of wage

increases in 1970 was the main expansive force in the economy. But in fact there is no automatic link between wages and demand. The level of demand depends on other factors besides wages and salaries, such as prices and taxation. And the Government, through its power to alter the level of taxation, can influence the level of demand. Thus the crucial factor is the action taken by the Government.

Unemployment is high because the Government wants it to be high, and it cannot hide its responsibility behind bogus theories. It has declared war on the trade unions and the most unscrupulous propaganda is the order of the day.

If the Heath-Barber doctrine is right, then West German workers should be pricing themselves out of their jobs just as fast as the British workers, because German wages rose by 14 per cent in 1970, almost exactly the same as in Britain. Yet unemployment in Germany, at about 150,000, remains very low and has shown no tendency to rise sharply as it has done here.

Inflation, which has plagued the British economy ever since the war and has suddenly become much more serious, is not at all a simple problem and we do not pretend to supply all the answers in this short pamphlet. It is affecting all the main industrialised capitalist countries; though there are grounds for thinking that, owing to the changed position of Britain's economy in the world, inflation is a more deep-rooted and difficult problem for us than for any other major industrialised country.

2. Why is the rate of inflation and unemployment so high?

We believe we can show that the crucial factor underlying both inflation and unemployment is the very slow rate of growth of the British economy from 1965 onwards. Except for a spurt in 1968 following the devaluation of the pound in November, 1967, this rate of growth has never exceeded 2 per cent a year. Total output in 1969 was 1.7 per cent higher than a year ago and in 1970 it was 1.5 per cent higher. Compare this with the growth of the industrialised countries in Western Europe of about 7 per cent in 1969 and 5½ per cent in 1970. As Vic Feather said in his pre-budget letter to the Chancellor of the Exchequer, "it is not wages that are too high, but output that is too low, because

demand is low".

We will consider the impact of this near-stagnation first on unemployment, and then on inflation.

3. Who is responsible for the large number of unemployed?

New plant and machinery is continually being installed, and new methods of working are being adopted, which increase the amount that can be produced by a given labour force. It is generally accepted that national productivity (national output per head) has been rising at an annual rate of 3 per cent or perhaps even more. This means that output will increase by 3 per cent in a year without any increase in the number of people employed. If the annual growth of output is less than 3 per cent, a smaller labour force will be needed by the end of the year (assuming that average hours of work remain the same) and the inevitable result will be an increase in the number of unemployed people.

Redundancies in particular firms may occur for a great variety of reasons. The firm may be suffering from bad management, or from a sudden change of fashion causing a drop in the demand for its products, or from rapid technological change, or be in an industry which is contracting. But if the economy as a whole is expanding fast enough, the demand for new goods and services will grow and the number of new jobs will exceed the number of redundancies.* This has not been happening during the past five years, because of the policies pursued by successive governments.

Unemployment was about 330,000 in the first half of 1966. After the Labour Government's price and wage freeze of July, 1966, and the accompanying deflationary measures to slow down the economy, unemployment rose to around 600,000 and remained at about that level until the summer of 1970; since then it has risen to its present level of over 800,000. There can be no doubt at all that this high level of unemployment is the result of deliberate Government policy. Above all, it is the refusal of the Tory Government, since it took office in 1970, to take the measures needed to speed up the expansion of the economy.

* The new jobs may not be in the right places or of the same kinds as the old ones. Only action by the state, through its regional policy, retraining facilities and other measures, can remedy this.

Ever since the immediate post-war years when the Labour Government maintained full employment, the techniques for managing the economy, so as to regulate its rate of growth, have become well understood. By varying the rates of taxation, the terms of hire purchase, the amount of bank lending and by other means, the Government can influence the level of total demand, and therefore the volume of output and employment. Thus a cut in purchase tax or income tax enables people to buy more goods, leading to a rise in output and in the number of jobs.

This was fully recognised by Mr. Barber in his budget speech of March 30. He said that, in the absence of any fresh stimulus from tax reductions, the economy would probably expand at the rate of about 2 per cent during 1971. He estimated that the additional buying power which would be put into the hands of the public by the tax cuts proposed in the budget, would increase the rate of growth of output to 3 per cent.

But this, as we have seen, is exactly equal to the estimated growth of national productivity. If Mr. Barber's estimates are right, unemployment will remain at about its present level during the next year. If he has over-estimated the rate of growth, unemployment will increase still further. In any case the policy of the Tory Government is clear—no reduction in unemployment.

It may seem at first sight that the differences between 2 or 3 or 4 per cent are not very significant. But they have a very big effect when applied to the total national output (gross domestic product), which is likely to be about £32,000m. this year. A rise in the rate of growth from 2 to 5 per cent would reduce unemployment by about 300,000 and result in the production of additional goods and services worth nearly £1,000m. That is why the TUC has repeatedly demanded that the Government should speed up the rate of economic expansion to 5 or 6 per cent a year, and maintain that rate at least until the number of unemployed has fallen to a low level.

4. Why, then, does the Government refuse to expand the economy more rapidly?

Mr. Heath says: "We are committed to growth as an object of policy; and we see it frustrated by cost inflation." This is mere propaganda. The real reason was more frankly given in the

February issue of *The Banker*, a monthly publication reflecting the views of the banking fraternity in the City:

"More demand, faster growth, and less unemployment would surely intensify the militant union pressure for an ever-growing share of wages in the national income."

And Mr. Davies, Minister for Trade and Industry, said in the debate on the budget (31.3.71):

"... the pursuit of profit is the primary stimulus of industry and the absence of an expectation of it is the primary cause of stagnation and decline".

The fact is that the trade unions achieved a temporary success, during 1969 and 1970, in increasing the share of wages in the national income at the expense of profits. Gross trading profits of companies, as a proportion of the national income, declined from 13.5 per cent in 1968 to 12.6 per cent in 1969 and to 11.6 per cent in 1970.* The share of wages and salaries rose in proportion. There has been a small reduction, in this one particular field, in the gross inequality which prevails in our society.

This fall in profits explains the ferocity of the Tory propaganda against the trade unions, the Government's aggressive policy against wage claims in the public sector and the Industrial Relations Bill. It explains the Government's rejection of any form of price control in the private sector, because the employers must be left free to raise prices in order to restore their profit margins. And it explains the budget and the preceding mini-budget of November, 1970.

The budget effects a massive redistribution of income in favour of the tiny minority of families, numbering about 300,000, whose incomes exceed £5,000 a year. For the great majority of the wage and salary earners, the benefits from the cuts in income tax will be broadly offset by the increased charges for school meals, the abolition of cheap welfare milk, the abolition of the first three days' sick and unemployment benefit, and the increased national insurance contributions which become due in September. But companies benefit this year to the extent of £260m. from the 5 per cent cut in corporation tax and the halving of SET (except in so far as the benefit of any cuts in SET are passed on to consumers in lower prices), even after paying

* The big companies who own large foreign investments made substantially increased profits abroad, but these figures relate to profits made in the UK.

the extra national insurance contributions due in September. And a company director (married without children) getting £30,000 a year will gain £3,574 or £68.70 a week.

On top of all this, the Government has imposed a new type of levy on imports of meat, cereals and dairy products, which will push up food prices by an amount which cannot be estimated in advance; and it has plans (not yet finalised) for big increases in the rents of council houses and of houses owned by private landlords.

The effect of the measures taken by the Tories since they took office has been to raise prices still further, and to increase the inequality of incomes. Of course they, like everyone else, are in favour of more rapid growth and against inflation, but the increase of profits at the expense of wages comes first.* That is their priority.

5. So the Tories have made the inflation worse. But what started it off?

Between 1961 and 1966 the average rate of price rise, measured by the official retail price index, was 3.6 per cent a year. In 1966–67 the price and wage freeze reduced it to 2.5 per cent. After the devaluation of the pound in November, 1967, the rate of inflation increased: prices in 1968 were 4.7 per cent above their level of a year ago, and in 1969 there was a further rise of 5.4 per cent. During 1970 the rate at which prices were rising continued to increase, and since March prices have been more than 8 per cent higher than a year ago.

The crucial question that has to be answered is: what was the cause of the acceleration of the rate of inflation after 1967? It would not be so serious if prices were now rising at the pre-1966 rate of about 3½ per cent a year. It is the continued increase since then that gives rise to such deep concern.

There really is no shadow of doubt that the initial cause of the acceleration in price rises was the devaluation of the pound, accompanied as it was by a sharp increase in indirect taxation. Three main effects can be distinguished:

(1) The prices of imported materials rose sharply, and in 1968 were 11½ per cent above their 1967 level, whereas the previous

* There are other factors as well which inhibit the Tories from adopting a policy of growth. See Question 9.

annual rise for many years past had been only 1.3 per cent. Import prices are now about 20 per cent above their pre-devaluation level.

(2) A heavy increase in taxation was imposed by the budget in 1968 in order to keep down consumption and shift resources into exports, and this taxation mainly took the form of increased taxes on spending, such as purchase tax, and petrol tax, and selective employment tax, which added to prices. Taxes on spending (indirect taxes) increased by 28 per cent between 1967 and 1969.

(3) Bank rate was raised from 6½ per cent to 8 per cent at the time of devaluation, giving a sharp upward push to all domestic interest rates, and world interest rates have also risen steeply in recent years. The average level of bank rate from 1967 to 1970 has been 50 per cent above the average of the previous five years. Local authorities have had to pay between 9 and 10 per cent for long-term loans since early in 1969, resulting in sharp increases in council house rents, mortgage payments have risen rapidly, and most building societies have been charging 8½ per cent since April, 1969. Companies have also had to pay around 10 per cent for loans and debentures at fixed rates of interest. The rising cost of capital has been an important factor in raising industrial costs and prices.

The *TUC Economic Review for 1971* estimated that the components of the 11½ per cent increase in retail prices between the end of 1967 and the end of 1969 were:

Increased import costs	**3 per cent**
Increased indirect taxes	**4 per cent**
Increased capital costs (approx.)	**1 per cent**
Increased wages and salaries	**3–4 per cent**

Thus in the period 1967 to 1969 rising labour costs accounted only for about a third of the increase in prices. The main cause of the acceleration in the rate of inflation was devaluation and the associated tax increases, not wage increases.

"Britain now faces the worst inflation for twenty years. This is mainly the result of tax increases and devaluation."

This comes from the Tory Election Manifesto of May, 1970.

Thus even the Tories recognised, before they took office, that

the relation between wages and prices is not so simple as their unscrupulous propaganda now suggests. All kinds of other factors, besides wages, enter into the determination of prices.

One of these factors must be emphasised over and over again because it has operated as the crucial condition for the inflation, namely, the near-stagnation of the economy. An increase in wage costs can be absorbed by an increase in productivity if the economy expands fast enough. What matters is not the rise in wages, but the rise in **wages per unit of output.** To take a simple example, if any employer concedes a 6 per cent rise in wages and achieves a 6 per cent increase in output per head, the firm's wage costs per unit of output will not have risen at all.

This operates in the same broad way for the economy as a whole. The only time during the past five years when national output rose at all rapidly was in 1968 when it increased at nearly 4 per cent per year; and although average earnings rose by about 8 per cent, the wage and salary cost per unit of output rose by only 3.1 per cent. The effect was even more striking in the manufacturing sector, where output per head rose by 7.1 per cent and the wage and salary cost per unit of employment rose by less than 1 per cent.*

Thus we can sum up by saying that the acceleration of inflation was the result of devaluation and the accompanying Government measures, such as the increase in taxes on goods, operating in the condition of the very slow growth of the economy after 1968.

6. But have not wage increases played a larger part since 1969?

The table taken from the TUC Economic Review covered the two years up to the end of 1969. By that time the direct price-raising effects of devaluation and tax increases had tapered off. The size of the average pay increase gained by trade unions increased sharply towards the end of 1969. Hourly wage rates, which in 1969 were about 5.4 per cent higher than a year before, were running in 1970 at a level of 10.2 per cent higher than a year ago. Since the end of 1969 wage increases have become a larger component of price rises than in the previous period.

* Actually by 0.9 per cent. See *Productivity, Prices and Incomes, 1969, published by NEDO.*

But the trade unions were only attempting to keep the take-home pay of their members ahead of the accelerating inflation of 1968 and 1969. This can be illustrated very clearly from the current situation. A wage increase of 15 per cent may seem at first sight to be extravagant when the cost of living is rising at 8 or 9 per cent. But it is easy to show that this is not so.

Suppose a trade union puts in a claim for an increase of £4.20 a week for its members whose wages are at present £28 a week —an increase of 15 per cent. For the great majority the increase will be subject to income tax at the rate of 30.14 per cent, and there will be a small increase of 5p a week in the graduated insurance contribution. Together these will take £1.31 a week, leaving a net increase of £2.89 a week. This will be added to the existing take-home pay which, for a married man with two children under 11, is £24.01 a week. His take-home pay rises to £26.90. Thus an increase in gross pay of 15 per cent has been converted into a 12 per cent increase in take-home pay.

If prices continue to rise at the rate of 9 per cent for a year after the wage increase takes effect, then the real value of his take-home pay of £26.90 will in a year's time fall to £24.68—a real increase of £0.67 or 2.8 per cent. A claim for a 15 per cent rise in present conditions is very modest indeed. Moreover, if a wage increase of only 9 per cent is obtained, a calculation on the same lines shows that at the end of a year a married man with two children will suffer an actual **reduction** in the purchasing power of his wage by 1.6 per cent. He will be worse off than he was at the beginning of the year.

These illustrations are based on the current rate of inflation of 8 to 9 per cent. At the end of 1969 it was approaching 6 per cent, and wage increases of 10 or 12 per cent were essential in order to ensure a modest rise of 2 to 4 per cent in real living standards after a year.

As the TUC showed in its *Economic Review*, the advance of real take-home pay became very slow indeed from the mid-sixties onward. For male manual workers it was only about 5 per cent over the four years 1965 to 1969—an average rise of just over 1 per cent. This very slow rate of increase during the period of prices and incomes policies produced a deep sense of frustration among trade unionists and a determination to keep ahead of the ever-rising cost of living and achieve a reasonable

annual increase in their real standard of living.

"The wage explosion is the way in which, when all else fails, those who are able to do so protect their living standards." (Mr. Heath, June 16, 1970.)

So even Mr. Heath agreed, **before** the election, that the action of the trade unions was justified. They acted rationally in stepping up their claims. It is not their fault if rational behaviour on their part produced an irrational result in the shape of inflation. That is the consequence of the unplanned character of the capitalist system and of the way the system is being run by the present Government.

The near-stagnation of the economy continued throughout 1970 and is still continuing. Indeed, the rise in consumers' spending resulting from the bigger wage and salary increases of 1969–70 was the main factor which stimulated such economic expansion as did take place in 1970.* The only way to break out of the circle of wage and price increases is for the Government to take the steps needed to increase the rate of expansion of the economy. As the *National Institute Economic Review* has said, a "strategy of expansion" is needed, stimulated by a big reduction in indirect taxes which would have a price-reducing effect.† This is what Mr. Heath recommended in his famous June 16 statement, which said the Government should

"break into the price-wage spiral by acting directly to reduce prices. This can be done by reducing those taxes which bear directly on prices and costs . . . This would, at a stroke, increase production and reduce unemployment."

But his Government is now pursuing exactly the opposite policy.

7. Are there any other factors causing inflation?

Britain is not the only country suffering from inflation. The acceleration of the rate of price rises in 1969–70 has been an international phenomenon, affecting all the main advanced capitalist countries. It is not at all easy to disentangle the causes affecting different countries, but it seems that price increases of goods entering into international trade have been transmitted from one country to another via foreign trade, capital move-

* *National Institute Economic Review*, February 1971, p.10
† Ibid, p.32.

ments and inflationary expectations.* Price increases in one country have encouraged manufacturers of competing goods in other countries to raise their prices. The great expansion in international trade in manufactured goods, and the growth of multinational companies, has made it easier for countries to export inflation to each other. Rising interest rates are rapidly communicated from one country to another. This only tends to confirm, once again, that the causes of inflation are complex and cannot be reduced, in a ridiculously oversimplified fashion, to wage increases.

8. Would a de-escalation of wage and salary increases help?

The Tory Government claims that this is the only solution: there must be a reduction in the level of pay settlements before any further steps can be taken to expand the economy. If the Tory strategy of de-escalation were to come about, there would of course be a very sharp reduction in standards of living. With a 9 per cent rate of inflation, a 9 per cent wage increase for a married man with two children earning £28 a week would result in a decline in his real earnings of 1.6 per cent after a year, as we showed above. Wage or salary increases of less than 9 per cent would mean an even sharper fall in living standards. Only a trade union movement intent on committing suicide would accept the Tory policy of de-escalation, which would also tend to reduce the demand for goods and thus to increase unemployment. A policy of de-escalation is wrong because it is based on the wrong assumption that wage increases are the prime cause of inflation.

The only way out is a strategy of expansion.

9. What are the obstacles to a strategy of expansion?

The fears of the Government and the employers, that faster economic growth and less unemployment would strengthen the trade unions and lead to a further increase in wages at the expense of profits, has already been mentioned (Question 4). This is probably the most immediate factor influencing the Government, which is bent on inflicting a defeat on the trade union

* See the OECD report *Inflation. The Present Problem, December 1970,* and the *National Institute Economic Review,* February 1971.

movement, weakening its bargaining power and thus finding a temporary solution to the crisis at the expense of the working class, and without making any of the fundamental changes in the economy which are required. But there are other obstacles to growth, arising out of Government policy, which can be listed as follows:

1. The need for a substantial balance of payments surplus to pay the cost of entry into the Common Market.

2. The continued existence of three traditional burdens which have acted as a drag on economic growth ever since the war: military spending, the City's role as world banker, and foreign investment.

3. The weakness of Britain's economic structure, resulting from years of slow growth and under-investment which were the consequence of these burdens.

10. How does the prospect of entry into the Common Market act as an obstacle to growth?

The exact cost of joining the Common Market depends on the outcome of the negotiations, which will settle the size of the payment which Britain will have to make to the Community's Agricultural Fund and the rate at which this payment will build up during the transitional period. But there can be no doubt that the payment will be substantial and that added to the other costs of entry which are already known, such as the loss of our preferential markets in the Commonwealth, a heavy strain could be imposed on our balance of payments which could be of the order of £500m. a year or more within a few years of entry.

The surplus in the balance of payments on current account in 1970 was £630m., but more rapid economic growth could result in a quite rapid erosion of this surplus (see Question 12). This is because more rapid growth could lead to a big increase in imports. In other words, the continuation of a very slow rate of economic growth is a condition for continuing to earn large surpluses in the balance of payments. But why do we need such large surpluses?

Mr. Barber has admitted that the cost of joining the Common Market is one of the factors making a large surplus necessary. He said:

"It is essential that we go on earning a substantial current surplus in the future. If the European negotiations succeed, we need to be in a position to carry the initial costs of entry."*

Mr. Vic Feather has asked:

"Why is the Chancellor content to keep sitting on a surplus of this size (£600m. a year) when a surplus of much less than that would be perfectly satisfactory? ... I believe there is a growing suspicion that the Chancellor is sitting on the surplus so that the Government can be ready to pay the admission charge to the Common Market."

If this was so, he went on, two things were clear:

"The Government have firmly decided already that they are determined to take us into the Common Market. It also means they are prepared to inflict rising prices and rising unemployment on the people of Britain in order to get us into Europe, and that price is too big a price to pay.†

11. What are Britain's traditional burdens which tend to restrict economic growth?

Every British government is in favour of economic expansion. Mr. Heath says that the Tories "are committed to economic growth". But there are always other priorities, other policy aims which in practice come first. There have been three major priorities which have placed a heavy burden on the balance of payments since the war and are still continuing to do so.

1. Military spending. In spite of the steps taken to run down our overseas bases in the Far East and Middle East, overseas military expenditure was still £275m. in 1970, of which the Rhine army absorbed about £130m. No other Western industrial country except the United States bears such a heavy burden. Without this expenditure, the surplus in the balance of payments in 1970 would have been £900m. It is true that elaborate arrangements are made each year for the West German Government to buy certain equipment from us to offset the cost of the Rhine army, but Sir Frederick Catherwood, Director General of the National Economic Development Office 1966–71 has written that "it now seems to be admitted that much of the so-called

* Speech to Overseas Bankers' Club, reported in the *Financial Times*, 2.2.71. The other reasons why a large surplus was needed were: "to build our reserves, and to finance the net outflow for export credit, for aid to developing countries, and for overseas investment."

† *The Times*, 26.4.71.

'offset' items were an optical illusion."*

He has also said:

"The importance of currency payments on defence account can be seen by contrasting the position of West Germany with the United Kingdom. In the 1960s West Germany received from the stationing of British and American troops foreign currency which, after agreed 'offset' purchases, amounted to at least £1,500m. The UK, by contrast, paid out £2,500m. less negligible offset benefits, for its troops around the world; the difference between the two countries over 10 years on this one item alone is a staggering £4,000m."†

In addition to the overseas burden, the domestic burden of arms expenditure has been very heavy. Ever since the war we have devoted a larger proportion of our scientific and engineering resources to military purposes than any other country in Western Europe. This has in particular weakened the ability of our engineering and electronics industries to compete in world markets. The 1967 TUC demanded a drastic reduction of military expenditure as one element in a policy of full employment and real growth in wages and salaries.

2. The City of London as World Banker. The danger of the speculative selling of sterling imposes a severe handicap on steady economic growth. This danger arises from the huge sterling balances held in London by foreign banks and traders and the big multi-national companies, now amounting to about £2,700m. These balances take various forms such as deposits with British banks, holdings of government securities or loans to local authorities, but they all have one feature in common, namely, they can be withdrawn at short notice and converted into dollars or marks or other currencies. Bad news about the British balance of payments, even if it is only a minor setback, can cause foreigners to lose confidence in the pound, fearing that it will be devalued and that they will make a serious loss. Accordingly they lift their telephones and in a flash the money is transferred to New York or Frankfurt or some other financial centre.

Thus a temporary deficit in our balance of payments of, say, £200m. can be rapidly converted into a deficit two or three times as large by a sudden outflow of "hot money". Between February

* *Lloyds Bank Review*, April 1971.

† The *Observer*, 14.3.71.

and June, 1966, there was an outflow of some £500m. Faced with such an outflow, the British Government is compelled to damp down the growth of the economy in order to try and restore the confidence of foreign investors. For they tend to think like bankers—that when anything is wrong it can be put right by a credit squeeze and by the curbing of wages and public spending.

The whole system of international finance in the West, in which London plays a key role, requires absolute freedom for foreign investors and speculators to move their money from one country to another in pursuit of short-term gains. Indeed, one of the reasons for the high rates of interest in Britain (which have contributed to inflation as we saw earlier—Question 5) has been the Government's desire to attract the maximum amount of money to London. In 1970 no less than £900m. of short-term funds flowed into London; but how long will they stay? Faster growth, which would diminish our balance of payments surplus, might not please all these foreign investors. So long as a high priority continues to be given to the City of London's world banking role, the stable growth of the economy will be continually threatened.

3. Foreign investment. Total investment abroad in 1970 reached the very high total of £735m., of which the greater part was direct investment by British multi-national companies in their foreign subsidiaries. It is true that this was offset by an inflow of investment by foreign companies (mainly American) to the extent of £665m. But we cannot indefinitely rely on the continued inflow of American investment on this huge scale; it might rapidly fall off—especially if our growth rate remains so much below that of other countries—and in any case the increasing foreign ownership of many key sectors of British industry has grave disadvantages. Mr. Barber himself considers that the need to finance foreign investment is one of the reasons why we need a surplus in our balance of payments (in addition to paying the cost of entry into the Common Market—see Question 10).

Of course it may be far more profitable for the big multinational companies (ICI, Courtaulds, Guest, Keen and Nettlefold, Dunlop, etc.) to invest their money abroad at a time when their markets in Britain are expanding so much more slowly than foreign markets. Company profits made abroad more than

doubled between 1962 and 1969, rising from £274m. to £642m., whereas those made at home rose by little more than one third.

So long as a surplus in the current balance of payments to finance private overseas investment remains a prime object of government policy, the rate of growth of the British economy will have to be slower than it otherwise would be.

These three traditional priorities—military spending, overseas investment and international banking—are in many ways bound up with each other and with Britain's former position as the centre of an Empire. Foreign military bases helped to protect foreign investments (oil in the Middle East, etc.) and London's financial operations helped to preserve a privileged position for British exports in Commonwealth markets. But their combined burden on the balance of payments slowed down the momentum of the British economy to a pace well behind that of its unburdened foreign rivals. Companies will not invest on a large scale unless they see the prospect of expanding markets ahead. The result has been that Britain's rate of industrial investment has been well below that of its competitors, and our share of world trade in manufactured exports has declined from 16½ per cent in 1960 to 10½ per cent in 1970. British governments have been using precious economic resources in defending privileged markets for capital and goods long after they became indefensible. British capitalism has failed to adjust itself to the loss of Empire.

12. If the three traditional burdens were lightened, would the British economy be able to expand rapidly?

Since British industry is suffering from the cumulative effect of a prolonged period of chronically slow growth caused by these three traditional burdens, it must be evident that, even if they were lightened—and even if the additional burden of joining the Common Market were avoided—our critical economic difficulties would not vanish overnight. We should gain a valuable breathing space. It would be possible to allow more rapid expansion, but unless the opportunity was seized by the Government to bring about fundamental changes, new problems could soon arise.

The recent trend of imports and exports constitute a serious warning. In money terms, the value of our exports rose by 12 per cent in 1970; but much of this rise was the result of higher

prices, and since mid-1970 there has been no increase at all in the volume of exports. On the other hand, the volume of imports rose by 9 per cent in 1970 although their average price was actually tending to fall. Things cannot go on like this for very long. It is essential that the volume of our exports should start to rise again.

If the economy were to expand at a rate of 5 or 6 per cent so as to cut down unemployment, imports would certainly increase at a substantial rate in order to supply the needs of industry for materials and the growing market for consumer goods. But there would be no guarantee that exports would grow at the same rate. There would therefore be a grave danger that a deficit in our trade balance would grow, until steps had to be taken to slow down the rate of growth once again. The day of reckoning could be deferred by the use of a system of import controls on inessential imports, but only for a time.

The problem of exports has been highlighted in a recent NEDO Discussion Paper, *Trade Balance in the 1970s. The Role of Mechanical Engineering*. The author, Mr. D. T. N. Williamson, who is Director of Research of Molins Ltd., points out that mechanical engineering is our most important exporting industry, but that its export balance (exports less imports) steadily declined in the 1960s and, if existing trends are projected into the future, would vanish altogether in the 1980s. In other words, imports of foreign machinery have been growing faster than exports of British machinery. The evidence shows that "the success of foreign machines in the home market depends on their technical performance and this generally far outweighs considerations of price and delivery". He concludes that temporary measures such as devaluation provide no lasting remedy; what is required is "a modification of the whole economic environment", which can never be achieved by unfettered market forces but only by means of far-reaching measures of selective intervention by the state to strengthen the most promising sectors and to secure the necessary changes in industry.

These views are all the more telling because they are published by such a respectable source as the National Economic Development Office (which is not responsible for Mr. Williamsons's views). It is obvious that they are utterly opposed to the philosophy of the present Tory Government with its dogmatic belief in market forces. The necessary fundamental changes in

the structure of British industry can only come about through massive state action, and many of those working in particular industries may consider that nationalisation is an essential condition for advance in their industry.

13. What are the essential features of a strategy of expansion?

Such a strategy could develop in three main stages.

First, a big reduction in indirect taxes, which would stimulate the growth of the economy and at the same time have a valuable price-reducing effect (Question 6). The reduction in indirect taxes could be all the larger if it was accompanied by an increase in taxation of the rich; thus a wealth tax, repeatedly proposed by the TUC, could be imposed on the 10 per cent of the adult population owning 75 per cent of all property. In short, there would have to be a complete reversal of the Tory Government's tax policy.

Second, in order to enable the economy to expand steadily and to reach full employment without running into a balance of payments crisis, steps could be taken to lighten Britain's three traditional burdens which have acted as a drag on growth—military spending, foreign investment, and London's world banking role (Question 11). Selective import controls could also be a help. The problem of joining the Common Market also falls into this second stage (Question 10).

Third, the opportunity created during the period of more rapid expansion could be used to bring about the necessary fundamental changes in British industrial structure.

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